

PERAC AUDIT REPORT



Melrose Contributory Retirement System

JAN. 1, 2003 - DEC. 31, 2005 / PERAC 05: 12-059-15



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PERAC

COMMONWEALTH OF MASSACHUSETTS | PUBLIC EMPLOYEE RETIREMENT ADMINISTRATION COMMISSION

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KENNETH J. DONNELLY | JAMES M. MACHADO | DONALD R. MARQUIS | THOMAS TRIMARCO

JOSEPH E. CONNARTON, *Executive Director*

October 25, 2006

The Public Employee Retirement Administration Commission has completed an examination of the Melrose Retirement System pursuant to G.L. c. 32, § 21. The examination covered the period from January 1, 2003 to December 31, 2005. This audit was conducted in accordance with the accounting and management standards established by the Public Employee Retirement Administration Commission in regulation 840 CMR 25.00. Additionally, all supplementary regulations approved by PERAC and on file at PERAC are listed in this report.

In our opinion, the financial records are being maintained and management functions are being performed in conformity with the standards established by the Public Employee Retirement Administration Commission with the exception of those noted in the findings presented in this report.

In closing, I acknowledge the work of examiners James Sweeney and James Tivnan who conducted this examination and express appreciation to the Board of Retirement and staff for their courtesy and cooperation.

Sincerely,



Joseph E. Connarton
Executive Director



Melrose Retirement System

EXPLANATION OF FINDINGS AND RECOMMENDATIONS

FOR THE THREE-YEAR PERIOD ENDING DECEMBER 31, 2005

I. Reconciliation of Cash Accounts

The Board is not receiving a formal cash reconciliation for the operating bank accounts from the City Treasurer. This was also a finding in the previous Audit Report.

Recommendation: The City Treasurer shall be the custodian of the retirement system's funds according to G.L. c. 32, § 23(2)(a). As custodian of the retirement fund, the Treasurer is obligated to perform a monthly reconciliation of all retirement system cash accounts. This process is necessary to maintain proper internal control of the retirement system by segregating reconciliation duties. The Treasurer must be instructed to provide appropriate paperwork (bank statement, reconciliation, and outstanding check list) to the Retirement Board on a monthly basis for both operating accounts in a timely manner.

Board Response:

Despite repeated efforts, the Board has experienced great difficulties with the statutory retirement obligations of the Treasurer's office. The incumbent City Treasurer has recently resigned from the position, and a new, experienced City Treasurer has been appointed. The Board is confident that this issue will now be rectified.

2. Travel Expenses

During a review of the expenses of the system, it was observed that some vouchers submitted for travel expenses were not supported with sufficient detail to confirm the legitimate business purpose of the expenditure. It was observed that the system frequently reimbursed a Board member for expenses anticipated in advance of an actual conference. An official document reconciling the actual expenses with the advance paid was not required. Travel expenses are not submitted on a formal expense reimbursement document. Details for charges and receipts for meals are necessary to verify dates and validity of the expenses. The practice of allowing advances for meals at a daily per diem rate for meals while away from the office on official business has resulted in a disincentive for the collection of actual receipts for meals. There was confusion whether the per diem applied to meals supplied by a sponsor or included in the event. This led to uncertainty over what the per diem rate was designed to apply to. Without the confirmation of actual receipts, the legitimacy of the per diem rate could not be verified. We observed instances that indicated a meal was included or provided at the event as part of the registration or as part of a sponsor's participation.

The Board adopted travel regulations approved by PERAC effective May 1, 2002.

Recommendation: The Board must conform to PERAC's travel regulations as detailed in 840 CMR 2.00. The Board may adopt additional supplemental regulations to supplement and expand

Melrose Retirement System

EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

FOR THE THREE-YEAR PERIOD ENDING DECEMBER 31, 2005

upon these regulations. However, such regulations must be submitted to PERAC for review and approval as required by the provisions of G.L. c. 7, § 50 and c. 32, § 21 (4).

Board members must submit travel vouchers with detailed receipts, so that charges can be validated. The System is required to more closely review actual travel vouchers and receipts under the new regulations. Details for charges such as meals are necessary to verify dates and validity of the expenses. The Board must ensure that all vouchers contain detailed invoices before approving payment. Hotel folios are necessary to verify dates and validity of the expenses. A more detailed expense form needs to be adopted, similar to the City of Melrose Expense Reimbursement Form. The form should be standardized, state the purpose of the travel request, disclose the potential benefit or legitimate business purpose to the Board, be approved by the Board in advance and be supported with sufficient receipts and documentation to demonstrate the validity of this use of retirement funds. The form must be certified by the person requesting reimbursement.

The per diem reimbursement policy should be clarified. Original itemized receipts should be required. Most restaurants provide ample proof of patronage, detailed and itemized bills with payment receipt. Such detail will ensure that only actual meals consumed are reimbursed and prohibited items are eliminated from reimbursement.

Board Response:

The Board has since undertaken a thorough review of its expense reimbursement practices, including the use of per diem payments and improved reimbursement forms, to ensure that all expenses for education and travel comply with the Board's Travel Policy. The Board members and office staff will work closely to ensure that receipts are retained and attached to appropriate vouchers. The Board will review details regarding conference offerings. The Board will not make hotel payments in advance, but instead will require appropriate documentation on the reimbursement request form after a conference.

3. Membership

PERAC auditors sampled members' deduction rates to determine that correct percentages are being withheld and that the additional 2% deduction is withheld from those members who make over \$30,000 and were hired after January 1, 1979. One member who had a break in service of public employment was having retirement deductions taken at the rate in effect upon joining the Melrose Retirement System. This member had left her retirement deductions with the previous Board, which transferred the members' Annuity Savings deductions to the Melrose System.

Recommendation: Any member transferring from another System is entitled to the retirement deduction rate that was in effect at the time of transfer regardless of whether there is any break in Massachusetts public employment. This members' retirement deduction rate must be adjusted

Melrose Retirement System

EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

FOR THE THREE-YEAR PERIOD ENDING DECEMBER 31, 2005

and a refund of excess deductions made. Other members that transferred in since July, 2002 must be investigated to determine if correct rates are being withheld.

Board Response:

The Board has reviewed the contribution rates of members transferring to the system since July 2002, and has discovered two (2) cases which the Board has corrected.

4. Regular Compensation

There are several Collective Bargaining Agreements in the governmental units that include clothing allowance payments for employees. Retirement deductions are not withheld on these payments. These are regular recurring payments which must be classified as regular earnings for retirement purposes.

Recommendation: Clothing allowances must be considered regular compensation pursuant to 840 CMR 15.03(1)(a) which states in part:

“(a) To be considered regular compensation, any compensation to an employee must: ...

3. be ordinary, normal, recurring, repeated...

4. be made pursuant to an official written policy of the employer or to a collective bargaining agreement;”

The Board must formally instruct the payroll officers to begin withholding retirement deductions on clothing allowances paid to members. The rate of deduction must be the same as the member's other compensation plus the additional 2% if total compensation exceeds \$30,000 for any pay period.

Board Response:

Although 840 CMR 15.03(1) as recently amended does not specifically cite clothing allowances as regular compensation, the Board nevertheless will instruct the member units' payroll officers to commence regular compensation deductions for clothing allowances.

5. Excess 91A Earnings

An accidental disability retiree had excess earnings in 2002 and 2003. To date, the member has not refunded his excess earnings to the Retirement Board.

Recommendation: Each disability retiree is limited by G.L. c. 32, § 91A in the amount of earnings beyond the retiree's retirement benefit. The statute reads in part: “If such earnings exceed an amount which when added to the member's retirement allowance is greater than the amount of regular compensation which would have been payable to such member if such member had continued in service in the grade held by him at the time he was retired plus the sum of five thousand dollars, said member shall refund the portion of his retirement allowance for such preceding year equal to such excess and until such refund is made, his pension or retirement

Melrose Retirement System

EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

FOR THE THREE-YEAR PERIOD ENDING DECEMBER 31, 2005

allowance shall be held as security therefore.” The Board should immediately act to recover the retiree’s excess earnings for the years 2002 and 2003.

Board Response:

The accidental disability retiree will be notified of this overpayment and be requested to either reimburse the Board directly, or to establish a payment plan to deduct an appropriate amount from his monthly retirement allowance until the overpayment has been paid.

Final Determination:

PERAC auditors will follow-up in six (6) months to ensure that the appropriate actions have been taken regarding all findings.

Melrose Retirement System

STATEMENT OF LEDGER ASSETS AND LIABILITIES

**FOR THE THREE-YEAR PERIOD BEGINNING JANUARY 1, 2003
AND ENDING DECEMBER 31, 2005**

FOR THE PERIOD ENDING DECEMBER 31,			
ASSETS	2005	2004	2003
Cash	\$6,790,520	\$4,751,510	\$4,247,951
Short Term Investments			
Fixed Income Securities	6,006,628	8,079,279	9,937,463
Equities		7,920,334	7,519,315
Pooled Short Term Funds			
Pooled Domestic Equity Funds	17,994,779	6,815,321	6,467,995
Pooled International Equity Funds	4,982,534	4,814,016	4,538,434
Pooled Global Equity Funds	6,455,615	5,330,064	3,386,827
Pooled Domestic Fixed Income Funds			
Pooled International Fixed Income Funds			
Pooled Global Fixed Income Funds			
Pooled Alternative Investment Funds	1,073,093	790,922	531,373
Pooled Real Estate Funds	2,566,826	1,990,797	1,667,653
Pooled Domestic Balanced Funds	9,823,262	11,514,657	10,276,019
Pooled International Balanced Funds			
PRIT Cash Fund			
PRIT Core Fund			
Interest Due and Accrued	86,029	113,493	147,478
Accounts Receivable	7,454	(3,407)	3,497
Accounts Payable	11,336		
TOTAL	<u>\$55,798,076</u>	<u>\$52,116,987</u>	<u>\$48,724,004</u>
FUND BALANCES			
Annuity Savings Fund	\$11,573,101	\$10,977,622	\$10,385,309
Annuity Reserve Fund	6,919,816	7,033,776	7,172,906
Pension Fund	5,600,912	6,352,879	7,311,412
Military Service Fund	3,644	3,446	3,285
Expense Fund	0	0	0
Pension Reserve Fund	31,700,603	27,749,263	23,851,091
TOTAL	<u>\$55,798,076</u>	<u>\$52,116,987</u>	<u>\$48,724,004</u>

Melrose Retirement System

STATEMENT OF CHANGES IN FUND BALANCES

**FOR THE THREE-YEAR PERIOD BEGINNING JANUARY 1, 2003
AND ENDING DECEMBER 31, 2005**

	Annuity Savings Fund	Annuity Reserve Fund	Pension Fund	Military Service Fund	Expense Fund	Pension Reserve Fund	Total All Funds
Beginning Balance (2003)	\$10,639,242	\$6,603,970	\$8,102,426	\$1,644	\$0	\$17,862,005	\$43,209,288
Receipts	1,278,074	192,984	4,290,222	60	343,659	5,986,557	12,091,556
Interfund Transfers	(1,175,526)	1,171,416	0	1,581	0	2,529	0
Disbursements	<u>(356,481)</u>	<u>(795,464)</u>	<u>(5,081,235)</u>	<u>0</u>	<u>(343,659)</u>	<u>0</u>	<u>(6,576,839)</u>
Ending Balance (2003)	10,385,309	7,172,906	7,311,412	3,285	0	23,851,091	48,724,004
Receipts	1,500,097	208,309	4,599,133	161	427,300	3,890,729	10,625,729
Interfund Transfers	(532,547)	525,104	0	0	0	7,443	0
Disbursements	<u>(375,238)</u>	<u>(872,543)</u>	<u>(5,557,666)</u>	<u>0</u>	<u>(427,300)</u>	<u>0</u>	<u>(7,232,746)</u>
Ending Balance (2004)	10,977,622	7,033,776	6,352,879	3,446	0	27,749,263	52,116,987
Receipts	1,540,680	208,309	5,047,548	198	491,607	3,958,872	11,247,214
Interfund Transfers	(578,522)	586,055	0	0	0	(7,532)	0
Disbursements	<u>(366,678)</u>	<u>(908,323)</u>	<u>(5,799,515)</u>	<u>0</u>	<u>(491,607)</u>	<u>0</u>	<u>(7,566,124)</u>
Ending Balance (2005)	<u>\$11,573,101</u>	<u>\$6,919,816</u>	<u>\$5,600,912</u>	<u>\$3,644</u>	<u>\$0</u>	<u>\$31,700,603</u>	<u>\$55,798,076</u>

Melrose Retirement System

STATEMENT OF INCOME

FOR THE THREE-YEAR PERIOD BEGINNING JANUARY 1, 2003
AND ENDING DECEMBER 31, 2005

	FOR THE PERIOD ENDING DECEMBER 31,		
	2005	2004	2003
Annuity Savings Fund:			
Members Deductions	\$1,284,512	\$1,152,509	\$1,110,658
Transfers from other Systems	143,918	262,241	23,918
Member Make Up Payments and Redeposits	48,405	25,016	41,835
Investment Income Credited to Member Accounts	63,846	60,332	101,663
Sub Total	<u>1,540,680</u>	<u>1,500,097</u>	<u>1,278,074</u>
Annuity Reserve Fund:			
Investment Income Credited Annuity Reserve Fund	<u>208,309</u>	<u>208,309</u>	<u>192,984</u>
Pension Fund:			
3 (8) (c) Reimbursements from Other Systems	59,845	50,358	49,293
Received from Commonwealth for COLA and Survivor Benefits	381,453	256,684	126,372
Pension Fund Appropriation	<u>4,606,250</u>	<u>4,292,091</u>	<u>4,114,556</u>
Sub Total	<u>5,047,548</u>	<u>4,599,133</u>	<u>4,290,222</u>
Military Service Fund:			
Contribution Received from Municipality on Account of Military Service	0	0	0
Investment Income Credited Military Service Fund	<u>198</u>	<u>161</u>	<u>60</u>
Sub Total	<u>198</u>	<u>161</u>	<u>60</u>
Expense Fund:			
Expense Fund Appropriation	0	0	0
Investment Income Credited to Expense Fund	<u>491,607</u>	<u>427,300</u>	<u>343,659</u>
Sub Total	<u>491,607</u>	<u>427,300</u>	<u>343,659</u>
Pension Reserve Fund:			
Federal Grant Reimbursement	0	0	0
Pension Reserve Appropriation	0	0	0
Interest Not Refunded	2,700	407	1,730
Miscellaneous Income	477,194	2,462	4,787
Excess Investment Income	<u>3,478,978</u>	<u>3,887,860</u>	<u>5,980,041</u>
Sub Total	<u>3,958,872</u>	<u>3,890,729</u>	<u>5,986,557</u>
TOTAL RECEIPTS	<u>\$11,247,214</u>	<u>\$10,625,729</u>	<u>\$12,091,556</u>

Melrose Retirement System

STATEMENT OF DISBURSEMENTS

FOR THE THREE-YEAR PERIOD BEGINNING JANUARY 1, 2003
AND ENDING DECEMBER 31, 2005

	FOR THE PERIOD ENDING DECEMBER 31,		
	2005	2004	2003
Annuity Savings Fund:			
Refunds to Members	\$109,627	\$96,595	\$243,519
Transfers to other Systems	<u>257,052</u>	<u>278,643</u>	<u>112,961</u>
Sub Total	<u>366,678</u>	<u>375,238</u>	<u>356,481</u>
Annuity Reserve Fund:			
Annuities Paid	908,323	872,543	795,464
Option B Refunds	<u>0</u>	<u>0</u>	<u>0</u>
Sub Total	<u>908,323</u>	<u>872,543</u>	<u>795,464</u>
Pension Fund:			
Pensions Paid			
Regular Pension Payments	4,233,023	4,045,784	3,698,292
Survivorship Payments	330,179	309,779	296,954
Ordinary Disability Payments	119,933	134,201	130,858
Accidental Disability Payments	765,568	711,381	649,316
Accidental Death Payments	234,660	231,240	193,524
Section 101 Benefits	35,059	34,038	38,733
3 (8) (c) Reimbursements to Other Systems	81,093	91,242	73,559
State Reimbursable COLA's Paid	0	0	0
Chapter 389 Beneficiary Increase Paid	<u>0</u>	<u>0</u>	<u>0</u>
Sub Total	<u>5,799,515</u>	<u>5,557,666</u>	<u>5,081,235</u>
Military Service Fund:			
Return to Municipality for Members Who Withdrew Their Funds	<u>0</u>	<u>0</u>	<u>0</u>
Expense Fund:			
Board Member Stipend	19,417	19,250	19,500
Salaries	121,190	116,361	103,098
Legal Expenses	4,500	20,000	40,908
Medical Expenses	93	46	75
Travel Expenses	16,645	15,664	16,223
Administrative Expenses	7,560	6,908	10,453
Fiduciary Insurance	3,599	3,635	-
Furniture and Equipment	359	189	0
Management Fees	232,571	141,418	102,586
Custodial Fees	50,923	62,579	27,817
Consultant Fees	<u>34,750</u>	<u>41,250</u>	<u>23,000</u>
Sub Total	<u>491,607</u>	<u>427,300</u>	<u>343,659</u>
TOTAL DISBURSEMENTS	<u>\$7,566,124</u>	<u>\$7,232,746</u>	<u>\$6,576,839</u>

Melrose Retirement System

INVESTMENT INCOME

**FOR THE THREE-YEAR PERIOD BEGINNING JANUARY 1, 2003
AND ENDING DECEMBER 31, 2005**

	FOR THE PERIOD ENDING DECEMBER 31,		
	2005	2004	2003
Investment Income Received From:			
Cash	\$52,169	\$18,043	\$21,757
Short Term Investments	0	0	0
Fixed Income	468,092	520,681	615,337
Equities	111,434	140,456	76,813
Pooled or Mutual Funds	801,456	1,003,714	54,256
Commission Recapture	<u>13,346</u>	<u>9,608</u>	<u>1,321</u>
TOTAL INVESTMENT INCOME	<u>1,446,497</u>	<u>1,692,502</u>	<u>769,484</u>
Plus:			
Realized Gains	1,348,856	222,503	9,409
Unrealized Gains	2,384,220	3,879,124	10,066,047
Interest Due and Accrued on Fixed Income Securities - Current Year	<u>86,029</u>	<u>113,493</u>	<u>147,478</u>
Sub Total	<u>3,819,105</u>	<u>4,215,120</u>	<u>10,222,934</u>
Less:			
Paid Accrued Interest on Fixed Income Securities	(17,700)	27,049	49,417
Realized Loss	(391,706)	(368,166)	(169,690)
Unrealized Loss	(499,765)	(835,065)	(3,301,709)
Interest Due and Accrued on Fixed Income Securities - Prior Year	<u>(113,493)</u>	<u>(147,478)</u>	<u>(173,018)</u>
Sub Total	<u>(1,022,664)</u>	<u>(1,323,661)</u>	<u>(3,595,000)</u>
NET INVESTMENT INCOME	<u>4,242,938</u>	<u>4,583,961</u>	<u>7,397,417</u>
Income Required:			
Annuity Savings Fund	63,846	60,332	101,663
Annuity Reserve Fund	208,309	208,309	192,984
Military Service Fund	198	161	60
Expense Fund	<u>491,607</u>	<u>427,300</u>	<u>343,659</u>
TOTAL INCOME REQUIRED	<u>763,960</u>	<u>696,101</u>	<u>638,366</u>
Net Investment Income	<u>4,242,938</u>	<u>4,583,961</u>	<u>7,397,417</u>
Less: Total Income Required	<u>763,960</u>	<u>696,101</u>	<u>638,366</u>
EXCESS INCOME TO THE PENSION RESERVE FUND	<u>\$3,478,978</u>	<u>\$3,887,860</u>	<u>\$5,980,041</u>

Melrose Retirement System

STATEMENT OF ALLOCATION OF INVESTMENTS OWNED

(percentages by category)

FOR THE PERIOD ENDING DECEMBER 31, 2005

	MARKET VALUE	PERCENTAGE OF TOTAL ASSETS	PERCENTAGE ALLOWED
Cash	\$6,790,520	12.19%	100
Fixed Income	6,006,628	10.79%	40 - 80
Equities	0	0.00%	40
Pooled Domestic Equity Funds	17,994,779	32.31%	
Pooled International Equity Funds	4,982,534	8.95%	
Pooled Global Equity Funds	6,455,615	11.59%	
Pooled Alternative Investment Funds	1,073,093	1.93%	5
Pooled Real Estate Funds	2,566,826	4.61%	10
Pooled Domestic Balanced Funds	9,823,262	17.64%	
GRAND TOTALS	<u>\$55,693,257</u>	<u>100.00%</u>	

For the year ending December 31, 2005, the rate of return for the investments of the Melrose Retirement System was 10.13%. For the five-year period ending December 31, 2005, the rate of return for the investments of the Melrose Retirement System averaged 5.53%. For the 21-year period ending December 31, 2005, since PERAC began evaluating the returns of the retirement systems, the rate of return of the investments of the Melrose Retirement System was 9.79%.

Melrose Retirement System

SUPPLEMENTARY INVESTMENT REGULATIONS

FOR THE THREE-YEAR PERIOD ENDING DECEMBER 31, 2005

The Melrose Retirement System submitted the following supplementary investment regulations, which were approved by PERAC on:

July 10, 2001

16.08

1. Exemption of the Board and INVESCO from the second sentence of 840 CMR 17.04(1)(c) – This Regulation deals with the use of non-public information by managers and consultants. PERAC recognizes that, in making the investments contemplated by the INVESCO Funds delineated above, that sentence, which prohibits action until information is publicly disseminated, represents an undue burden on the ability of the Partnerships to operate. Consequently, the Melrose Retirement Board's request as it applies to 840 CMR 17.04(1)(c) is approved.

2. Exemption of the Board and INVESCO from 840 CMR 17.04(6), except as otherwise provided for in the Partnership Agreement and/or as disclosed in INVESCO's Form ADV. This Regulation deals with the Priority of Transactions and an investment manager's obligation to prioritize board transactions and provide the board with the opportunity to act prior to the manager acting, if applicable. PERAC recognizes that this Regulation may impede the ability of partnerships such as INVESCO's to operate. Upon receipt of a copy of the provisions of the Partnership Agreement and/or disclosures in the INVESCO Form ADV, the Commission will approve the Melrose Retirement Board's request as it applies to 840 CMR 17.04(6).

3. Exemption of the Board and INVESCO from 840 CMR 19.01(7)(a)(6) with respect to the management fees and the General Partner's Carried Interest to be received by the manager or the General Partner pursuant to the (a) Subscription Agreement, (b) Agreement as defined in the side letter, and/or (c)

Manager's Investment Advisory Agreement with respect to the Board's commitments to the Partnerships – PERAC recognizes the fact that the market, at the present time, is such that fee limitations, as outlined in these Regulations, result in limiting the number of partnerships available to the retirement boards. Consequently, the Melrose Retirement Board's request, as it applies to 840 CMR 19.01(7)(a)(6), is approved.

4. Exemption of the Board and INVESCO from 840 CMR 21.01(2), 21.01(3)(a), 21.01(4), and 21.01(5) to the extent as otherwise permitted under the applicable agreement – These Regulations prohibit certain transactions as follows: 21.01(2) prohibits the sale of securities not owned by the system at the time of the sale (short sales); 21.01(3)(a) permits the use of forward currency contracts in limited circumstances; 21.01(4) prohibits the use of call options; 21.01(5) prohibits the purchase of options other than as required to close out option positions. PERAC has received a letter dated August 22, 2000 from INVESCO that clarifies the possible use of options, futures, or other derivatives. In pertinent part, the letter states as follows:

“Although the above referenced funds do not expect to use options, futures, or other derivatives other than infrequently, if at all, futures and/or options would be used only for nonspeculative true hedging purposes. In general, we would anticipate their use, if at all,

Melrose Retirement System

SUPPLEMENTARY INVESTMENT REGULATIONS (Continued)

FOR THE THREE-YEAR PERIOD ENDING DECEMBER 31, 2005

for among other reasons to protect downside risk on public securities of companies distributed to the funds by the underlying portfolio funds we invest in and where a commitment to a fund was made in a non US currency to limit currency risk of the funds.”

PERAC approves the exemption of the Board and INVESCO from 840 CMR 21.01(2), 21.01(3)(a), 21.01(4), and 21.01(5) for the limited purpose of protecting downside risk on public securities of companies distributed to the funds by underlying portfolio funds and to limit currency risk of the funds where a commitment to a fund was made in a non US currency. Please be advised that this Supplemental Regulation as it exempts the Melrose Retirement Board from PERAC Regulations, only does so in relation to the INVESCO Funds that are the subject of the Supplementary Regulation. In all other circumstances, these Regulations apply to the Melrose Retirement Board. The Supplementary Regulations approved herein are applicable only to the Melrose Retirement System’s investment in the INVESCO Venture Partnership Fund III, L.P. Exemption from the regulations pertaining to prohibited investments is limited to the purpose of protecting downside risk on public securities of companies distributed to the funds by underlying portfolio funds and to limiting currency risk of the funds where a commitment to a fund was made in a non-U.S. currency.

September 3, 1997

Equity investments shall not exceed 55% of the portfolio valued at market, including international equities which shall not exceed 15% of the portfolio valued at market.

July 27, 1989

(I) Real estate investments shall not exceed 5% of the total book value of the portfolio provided that:

- (a) trust participants or limited partners do not participate in the selection of trustees or general partners and should a trust participant or limited partner be required to participate in the selection of a trustee or general partner, prior to any participation by the board, the board shall consult with PERAC to determine the appropriate course of action, and
- (b) such trustees or general partners retain authority in the decision making process and
- (c) should an investment in a trust or limited partnership result in the direct ownership of real estate or mortgage indebtedness, such shall be permitted only until such time as divestiture of said trust or limited partnership is prudent.

Melrose Retirement System

NOTES TO FINANCIAL STATEMENTS

FOR THE THREE-YEAR PERIOD ENDING DECEMBER 31, 2005

NOTE I - THE SYSTEM

The plan is a contributory defined benefit plan covering all Melrose Retirement System member unit employees deemed eligible by the retirement board, with the exception of school department employees who serve in a teaching capacity. The Teachers' Retirement Board administers the pensions of such school employees.

Instituted in 1937, the System is a member of the Massachusetts Contributory Retirement System and is governed by Chapter 32 of the Massachusetts General Laws. Membership in the plan is mandatory immediately upon the commencement of employment for all permanent, full-time employees.

The system provides for retirement allowance benefits up to a maximum of 80% of a member's highest three-year average annual rate of regular compensation. Benefit payments are based upon a member's age, length of creditable service, level of compensation, and group classification.

Members become vested after ten years of creditable service. A superannuation retirement allowance may be received upon the completion of twenty years of service or upon reaching the age of 55 with ten years of service. Normal retirement for most employees occurs at age 65 (for certain hazardous duty and public safety positions, normal retirement is at age 55).

A retirement allowance consists of two parts: an annuity and a pension. A member's accumulated total deductions and a portion of the interest they generate constitute the annuity. The differential between the total retirement benefit and the annuity is the pension. The average retirement benefit is approximately 75 - 85% pension and 15 - 25% annuity.

Active members contribute either 5, 7, 8, or 9% of their gross regular compensation. Members joining the retirement system after January 1, 1979 must contribute an additional 2% on regular compensation earned at a rate in excess of \$30,000. The percentage rate is keyed to the date upon which an employee's membership commences. These deductions are deposited in the Annuity Savings Fund and earn interest at a rate determined by the Executive Director of PERAC according to statute. When a member's retirement becomes effective, his/her deductions and related interest are transferred to the Annuity Reserve Fund. Any cost-of-living adjustment granted between 1981 and 1997 and any increase in other benefits imposed by state law during that period are borne by the state.

The pension portion of any retirement benefit is paid from the Pension Fund of the System. The governmental unit employing the member must annually appropriate and contribute the amount of

Melrose Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE THREE-YEAR PERIOD ENDING DECEMBER 31, 2005

current year pension payments as indicated on the most recent funding schedule as approved by PERAC's Actuary. Until recently, retirement systems were paying only the actual retirement benefits that were due each year. Systems had no statutory authorization to put aside any money for the future benefits of employees who are now working. Large unfunded liabilities resulted from operating upon this pay-as-you-go basis. In 1977, legislation authorized local governments to appropriate funds to meet future pension obligations.

In 1983, additional legislation was passed requiring the transfer of investment earnings (in excess of the amount credited to member accounts) into the Pension Reserve Fund. These initiatives have significantly reduced the rate of growth of the retirement systems' unfunded liabilities, and in some systems have actually eliminated such liability.

Administrative expenses are funded through investment income of the system.

Members who become permanently and totally disabled for further duty may be eligible to receive a disability retirement allowance. The amount of benefits to be received in such cases is dependent upon several factors including: whether or not the disability is work related, the member's age, years of creditable service, level of compensation, veteran's status, and group classification.

Employees who resign from service and who are not eligible to receive a retirement allowance or are under the age of 55 are entitled to request a refund of their accumulated total deductions. In addition, depending upon the number of years of creditable service, such employees are entitled to receive either zero (0%) percent, fifty (50%) percent, or one hundred (100%) percent of the regular interest which has accrued upon those deductions. Survivor benefits are extended to eligible beneficiaries of members whose death occurs prior to or following retirement.

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES

The accounting records of the System are maintained on a calendar year basis in accordance with the standards and procedures established by the Executive Director of Public Employee Retirement Administration Commission.

The Annuity Savings Fund is the fund in which members' contributions are deposited. Active members contribute either 5, 7, 8, or 9% of their gross regular compensation. Voluntary contributions, re-deposits, and transfers to and from other systems, are also accounted for in this fund. Members' contributions to the fund earn interest at a rate determined by PERAC. Interest for some members who withdraw with less than ten years of service is transferred to the Pension Reserve Fund. Upon retirement, members' contributions and interest are transferred to the

Melrose Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE THREE-YEAR PERIOD ENDING DECEMBER 31, 2005

Annuity Reserve Fund. Dormant account balances must be transferred to the Pension Reserve Fund after a period of ten years of inactivity.

The Annuity Reserve Fund is the fund to which a member's account is transferred upon retirement from the Annuity Savings Fund and Special Military Service Credit Fund. The annuity portion of the retirement allowance is paid from this fund. Interest is credited monthly to this fund at the rate of 3% annually on the previous month's balance.

The Special Military Service Credit Fund contains contributions and interest for members while on a military leave for service in the Armed Forces who will receive creditable service for the period of that leave.

The Expense Fund contains amounts transferred from investment income for the purposes of administering the retirement system.

The Pension Fund contains the amounts appropriated by the governmental units as established by PERAC to pay the pension portion of each retirement allowance.

The Pension Reserve Fund contains amounts appropriated by the governmental units for the purposes of funding future retirement benefits. Any profit or loss realized on the sale or maturity of any investment or on the unrealized gain of a market valued investment as of the valuation date is credited to the Pension Reserve Fund. Additionally, any investment income in excess of the amount required to credit interest to the Annuity Savings Fund, Annuity Reserve Fund, and Special Military Service Credit Fund is credited to this Reserve account.

The Investment Income Account is credited with all income derived from interest and dividends of invested funds. At year-end the interest credited to the Annuity Savings Fund, Annuity Reserve Fund, Expense Fund, and Special Military Service Credit Fund is distributed from this account and the remaining balance is transferred to the Pension Reserve Fund.

NOTE 3 - SUPPLEMENTARY MEMBERSHIP REGULATIONS

The Melrose Retirement System submitted the following supplementary membership regulations, which were approved by PERAC on:

April 24, 2000

Creditable Service

[Non-elected] Board Members and Commissioners [who are compensated] will be granted membership, and if the salary is less than \$2500.00 annually, shall be credited with one year of

Melrose Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE THREE-YEAR PERIOD ENDING DECEMBER 31, 2005

creditable service for every three years of service rendered. Creditable service of one year shall be granted if the salary is more than \$2500.00 per year. This supplemental rule establishes rules for membership of compensated board members and commissioners in the City of Melrose and is consistent with the provisions of G.L. c. 32.

November 15, 1985

Amount of Creditable Service:

Part-time employees credit will be granted depending on the work history of the employee. Two categories of employment are considered as follows:

- A. Employees in this category will have worked on a less than full-time basis throughout their years of service. For this category of employee, credit will be granted on the basis of one (1) year of credit for each year of service. The pension thus computed will be on an equitable basis as a full time employee. The deciding factor in the computation of the pension will be the three-year average earnings.
- B. Employees in this category will have worked on both a full-time and part-time capacity during their years of service. In this category, credit for service will be computed on an individual basis. For the full-time service, the employee will receive one (1) year of credit for each year of service. For the part-time service, the employee will receive one (1) year of credit for two (2) years of part-time service. An alternate computation of creditable service will be made by using actual hours worked. This computation will be made using a ratio the dividend of which will represent the hours to be worked. The percentage thus computed will be that portion of a years of credit for the part-time work. Any interpretation of this paragraph shall be done on an individual basis by the Board.

July 1, 1985

Membership

Employees working less than 20 hours per week are ineligible for membership. Permanent employees working for at least 20 hours per week and less than 35 shall be granted creditable service pro-rated on the basis of a 40- hour week. If employed for at least 20 hours per week, and if this comprises the full time prescribed for the position, said part time employees shall be credited with 12 months membership service (i.e., Traffic Supervisors and School Lunch Employees). All regular permanent employees who work at least 35 or more hours per week shall be granted creditable service of 12 months for each year of employment.

Melrose Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE THREE-YEAR PERIOD ENDING DECEMBER 31, 2005

NOTE 4 - ADMINISTRATION OF THE SYSTEM

The System is administered by a five person Board of Retirement consisting of the City Auditor who shall be a member ex officio, a second member appointed by the governing authority, a third and fourth member who shall be elected by the members in or retired from the service of such system, and a fifth member appointed by the other four board members.

Ex officio Member: Patrick D. Dellorusso

Appointed Member: James E. Milano

Elected Member: John P. O'Neil Term Expires: 12/31/07

Elected Member: Gerald W. O'Neil Term Expires: 12/15/08

Appointed Member: Maria Zizza Term Expires: 01/01/08

The Board members are required to meet at least once a month. The Board must keep a record of all of its proceedings. The Board must annually submit to the appropriate authority an estimate of the expenses of administration and cost of operation of the system. The board must annually file a financial statement of condition for the system with the Executive Director of PERAC.

The investment of the system's funds is the responsibility of the Board. All retirement allowances must be approved by the Retirement Board and are then submitted to the PERAC Actuary for verification prior to payment. All expenses incurred by the System must be approved by at least two members of the Board.

The following retirement board members and employees are bonded by an authorized agent representing a company licensed to do business in Massachusetts as follows:

Treasurer - Custodian:)	
Ex officio Member:)	\$50,000,000 MACRS Policy
Elected Member:)	
Appointed Member:)	
Staff Employee:)	

Melrose Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE THREE-YEAR PERIOD ENDING DECEMBER 31, 2005

NOTE 5 - ACTUARIAL VALUATION AND ASSUMPTIONS

The most recent actuarial valuation of the System was prepared by the Public Employee Retirement Administration Commission as of January 1, 2004.

The actuarial liability for active members was	\$28,613,276
The actuarial liability for retired members and inactive	56,954,852
The total actuarial liability was	85,568,128
System assets as of that date were	52,131,208
The unfunded actuarial liability was	<u>\$33,436,920</u>
 The ratio of system's assets to total actuarial liability was	 60.9%
As of that date the total covered employee payroll was	\$12,853,822

The normal cost for employees on that date was 8.20% of payroll

The normal cost for the employer was 7.80% of payroll

The principal actuarial assumptions used in the valuation are as follows:

Investment Return: 8.00% per annum
Rate of Salary Increase: varies by job group and service

GASB STATEMENT NO. 25, DISCLOSURE INFORMATION AS OF JANUARY 1, 2004

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a % of Cov. Payroll ((b-a)/c)
1/1/2004	\$ 52,131,208	\$ 85,568,128	\$ 33,436,920	60.9%	\$ 12,853,822	260.1%
1/1/2002	\$ 50,134,256	\$ 77,123,164	\$ 26,988,908	65.0%	\$ 14,167,844	190.5%
1/1/2000	\$ 45,357,277	\$ 68,098,788	\$ 22,741,511	66.6%	\$ 13,121,423	173.3%

Melrose Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE THREE-YEAR PERIOD ENDING DECEMBER 31, 2005

NOTE 6 - MEMBERSHIP EXHIBIT

Retirement in Past Years	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Superannuation	12	7	15	11	13	14	37	21	10	12
Ordinary Disability	0	0	0	1	0	1	2	0	2	0
Accidental Disability	3	0	2	0	1	2	2	2		0
Total Retirements	15	7	17	12	14	17	41	23	12	12
Total Retirees, Beneficiaries and Survivors	343	338	334	338	350	345	375	388	389	395
Total Active Members	399	417	412	432	401	425	420	428	434	449
Pension Payments										
Superannuation	\$2,074,874	\$2,189,676	\$2,200,358	\$2,397,883	\$2,661,603	\$2,794,186	\$3,095,286	\$3,698,292	\$4,045,784	\$4,233,023
Survivor/Beneficiary Payments	220,185	232,311	220,523	238,165	256,648	277,881	292,728	296,954	309,779	330,179
Ordinary Disability	101,757	111,436	130,458	134,834	73,424	111,275	126,690	130,858	134,201	119,933
Accidental Disability	532,247	529,698	534,588	534,805	610,545	590,154	618,896	649,316	711,381	765,568
Other	<u>186,504</u>	<u>201,344</u>	<u>197,954</u>	<u>211,412</u>	<u>231,850</u>	<u>240,364</u>	<u>277,974</u>	<u>305,816</u>	<u>356,521</u>	<u>350,812</u>
Total Payments for Year	<u>\$3,115,567</u>	<u>\$3,264,465</u>	<u>\$3,283,881</u>	<u>\$3,517,098</u>	<u>\$3,834,069</u>	<u>\$4,013,860</u>	<u>\$4,411,575</u>	<u>\$5,081,235</u>	<u>\$5,557,666</u>	<u>\$5,799,515</u>

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